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2011

# Summit Operating, LLC v. Utah State Tax Commission and Auditing Division of the Utah State Tax Commission : Brief of Petitioner

Utah Supreme Court

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IN THE UTAH SUPREME COURT

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SUMMIT OPERATING, LLC,

Petitioner,

v.

UTAH STATE TAX COMMISSION  
AND AUDITING DIVISION OF  
THE UTAH STATE TAX  
COMMISSION,

Respondents.

Appeal No. 20110087

Agency No. 10-0119

Appeal from the Utah State Tax  
Commission

Administrative Law Judge: Kerry R.  
Chapman

Petition For Review

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BRIEF OF THE PETITIONER

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**UTAH APPELLATE COURTS**

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Addendum B: Order Granting Auditing Division's Motion for Summary Judgment and  
Denying Petitioners Cross-Motion for Summary Judgment

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## **JURISDICTION OF THE COURT**

The Utah Supreme Court has jurisdiction over this Petition for Review pursuant to Utah Code Ann. §78A-3-102(3) and Rule 14 of the Utah Rules of Appellate Procedure.

## **STATEMENT OF THE ISSUES**

Whether the Utah State Tax Commission erred in denying Summit Operating, LLC a tax exemption from the state oil and gas severance tax by ruling that the word “started” in the phrases “production for development wells started after January 1, 1990” and “production for wildcat wells started after January 1, 1990” in Utah Code Ann. §59-5-102(5) (2008) means “spudded” and does not modify the word production.

## **STANDARD OF REVIEW**

Correction of Errors. Utah Code Ann. §59-1-610.

(1) When reviewing formal adjudicative proceedings commenced before the [tax] commission, the Court of Appeals or Supreme Court shall:

- (a) grant the commission deference concerning its written findings of fact, applying a substantial evidence standard on review; and
- (b) grant the commission no deference concerning its conclusions of law, applying a correction of error standard, unless there is an explicit grant of discretion contained in a statute at issue before the appellate court.

*See also Savage Industries, Inc. v. Utah State Tax Com'n*, 811 P.2d 664 (Utah 1991); *SEMCO Industries, Inc. v. Auditing Div. of Utah State Tax Com'n*, 849 P.2d 1167 (Utah 1993).

Because the Utah State Tax Commission's application of U.C.A. § 59-5-102(2) in this case is a conclusion of law, this Court should give no deference to the Commission's decision and apply a correction of errors standard.

### **DETERMINATIVE STATUTES**

Utah Code Ann. §59-5-102 (2004) Severance tax -- Rate -- Computation -- Annual exemption -- Tax credit -- Tax rate reduction -- Study by Tax Review Commission.

(5) A tax is not imposed under this section upon:

....

(b) the first 12 months of production for wildcat wells started after January 1, 1990; or

(c) the first six months of production for development wells started after January 1, 1990.

### **STATEMENT OF THE CASE**

#### **a. Nature of the case**

This Petition for Review is from a final order of the Utah State Tax Commission issued on January 6, 2011. (Record, 074)

b. Course of Proceedings

On December 17, 2009, the Auditing Division of the Utah State Tax Commission (“Division”) issued a Statutory Notice to Petitioner for the period January 1, 2008 through December 31, 2008, in which it imposed additional severance tax in the amount of \$66,916.43 and interest in the amount of \$2,089.99 for a total assessment of \$69,006.42 determining that Petitioner’s Horsehead Point 18-44 natural gas well did not qualify for the six-month exemption in Utah Code Ann. §59-5-102 (1990). (R. 092)

Petitioner submitted a Petition for Redetermination and submitted the issue of the six-month tax exemption for review before the Utah State Tax Commission. (R. 001-002)

On July 22, 2010, the Division submitted a Motion for Summary Judgment and a Memorandum in Support of its Motion for Summary Judgment asking the Commission to find that the word “started” referred to the date which drilling on the Horsehead Point 18-44 natural gas well began. (R. 012 - 021)

On August 3, 2010, Petitioner filed Petitioner’s Cross-Motion for Summary Judgment and a Memorandum in Opposition to Division’s Motion for Summary Judgment and in Support of its Cross-Motion for Summary Judgment. (R. 026 – 041)

On August 16, 2010, the Division filed a Memorandum in Opposition of Petitioner's Cross-Motion. (R. 044 – 053)

On August 17, 2010, the Utah State Tax Commission held a hearing in which Petitioner and Division had an opportunity to present oral arguments on their respective motions. Commission D'Arcy Dixon Pignanelli was present with Commissioners R. Bruce Johnson, Commission Chair, Marc B. Johnson and Michael J. Cragun not present. (See R. 099)

The Utah State Tax Commission granted the Division's Motion for Summary Judgment and denied Petitioner's Cross-Motion for Summary Judgment on January 6, 2011. (See Addendum B)

Petitioner then paid the additional six-months taxes for the well on January 25, 2011.

This Petition for Review followed. (R. 074)

**c. Disposition at Agency**

The Utah State Tax Commission ruled 3 to 1 that "the Section 59-5-102(5)(c) exemption only applies to wells that were spudded after January 1, 1990" and granted the Division's Motion for Summary judgment and denied Petitioner's Cross-Motion for Summary Judgment. Petitioner was thereby denied a six-month exemption under the severance tax rules. Commissioners R. Bruce Johnson, Commission Chair, Marc B.

Johnson and Michael J. Cragun so ordered with Commissioner D'Arcy Dixon Pignanelli dissenting.

**RELEVANT FACTS WITH CITATION TO THE RECORD**

- a. The Horsehead Point 18-44 natural gas well in San Juan County, Utah, identified as entity number 6031, and subject to Federal Lease No. UTU - 40754, (the "Well") was spudded on August 28, 1983. (R. 093)
- b. The Well was completed as a well capable of producing natural gas on August 16, 1984. (R. 093)
- c. The Well was "shut-in" on August 20, 1984 after a flow test measuring natural gas flow was concluded. (See R. 066: 2 ¶ 4)
- d. Effective January 1, 1984, the Utah State Legislature enacted UCA §59-5-67(6) (1984) which provided an "exemption from the payment of occupation tax imposed by this article is allowed for a period of six months following the first day of production. Such exemption shall apply only to wells started after the January 1, 1984 effective date of this act." (See R. 066: 3 ¶ 7)
- e. In 1990, the Utah State Legislature enacted House Bill No. 110 which provided an exemption from severance tax for "the first 12 months of production for wildcat wells started after January 1, 1990" and the "first six months of production for development wells started after January 1, 1990." (Addendum A)

f. An original draft of the 1990 bill included the language “spudded” instead of “started”; however, the word “spudded” was intentionally removed and replaced with the word “started” before the bill was presented for enactment. (Addendum D)

g. On June 1, 2006, Petitioner acquired an interest in the Well. (R. 067: ¶ 5).

h. When Petitioner acquired the Well, it could not commercially produce natural gas because of its remote location and significant distance from a natural gas transportation pipeline and gas processing plant.

i. Petitioner thereafter constructed a natural gas gathering system pipeline to the Well in 2007 at a cost of over \$900,000.00. (R. 067: ¶ 5)

j. The Well production of natural gas started for the first time on January 7, 2008. (R. 097: Plaintiff’s Exhibit #3, Sundry Notices and Reports on Wells)

k. On December 17, 2009, the Division issued to Petitioner a Statutory Notice for the period of January 1, 2008 through December 31, 2008, in which it imposed six months additional severance tax to Petitioner in the amount of \$66,916.43 and interest in the amount of \$2,089.99 for a total assessment of \$69,006.42. (R. 092)

l. Petitioner claimed that the Well was subject to either the twelve-month or six-month exemption. Respondent disagreed.

m. Petitioner submitted the issue for review before the Utah State Tax Commission. (R. 001-002)

n. On July 22, 2010, Respondent submitted a Motion for Summary Judgment. Petitioner submitted Petitioner’s Cross-Motion for Summary Judgment. (R. 012-023).

o. A hearing was held on August 17, 2010, before the Utah State Tax Commission. (See R. 099)

p. On January 6, 2011, the Utah State Tax Commission issued an order for the Respondent ruling that the six month exemption only applied to wells “spudded” after January 1, 1990. Commissioner D’Arcy Dixon Pignanelli dissented in the order. (See Addendum A)

q. This Petition for Review followed. (R. 074)

### **SUMMARY OF THE ARGUMENT**

Utah Code Ann. 59-5-102(5)(c) allows for a six-month exemption for wells like the Horeshead Point 18-44 which only began or started production after January 1, 1990. The word “started” in the above-referenced statute does not mean “spudded” but either modifies the word production or is ambiguous. If the word “started” is ambiguous, it must be construed in a manner to conform with the intent of the Legislature. The Legislature intended to stimulate a weak energy industry in the State of Utah by incentivizing companies like Petitioner to invest in oil and gas wells which would have otherwise been uneconomic. Petitioner did invest substantial funds and provided jobs for residents of the State of Utah in order to begin production of the Well.

## DETAIL OF THE ARGUMENT

The Supreme Court of Utah has provided specific guidance for the interpretation of tax statutes. In *ExxonMobil v. Utah State Tax Commission*, 86 P.3d 706 (Utah 2003) the Court stated:

When we interpret a statute, we look first to the plain language. *In re Worthen*, 926 P.2d 853, 866 (Utah 1996). In doing so, we give all statutory provisions relevance and meaning independent of other provisions. *Id.* If we find ambiguity in the statute's language, we look to the legislative history and other policy considerations for guidance. *Id.* In the context of a taxation statute, our evaluation of ambiguous language also requires us to "construe taxation statutes liberally in favor of the taxpayer, leaving it to the legislature to clarify an intent to be more restrictive if such intent exists." *County Bd. Of Equalization of Wasatch County v. Utah State Tax Comm'n*, 944 P.2d 370, 373-74 (Utah 1997)(quoting *Salt Lake County v. State Tax Comm'n*, 770 P.2d 1131, 1132 (Utah 1989)).

86 P.3d 706 ¶ 14.

In *Parson Asphalt Products, Inc. v. Utah State Tax Commission*, 617 P.2d 397, 398 (Utah 1980) the Court stated:

Even though taxing statutes should generally be construed favorable to the taxpayer and strictly against the taxing authority, the reverse is true for exemptions. Statutes which provide exemptions should be strictly construed, and one who so claims has the burden of showing his entitlement to the exemption.

## PART I

### The Plain Language of the Statute is Difficult if not Ambiguous



In ruling against Petitioner, the Utah State Tax Commission chose to substitute the word “started” with the word “spudded” so that the relevant statute now reads for practical purposes:

“A tax is not imposed under this section upon the first six months of production for development wells spudded after January 1, 1990.”

However, this is not how the statute reads. Instead, it provides for a severance tax holiday “for the first six months of production for development wells started after January 1, 1990.” Utah Code Ann. § 59-5-102(5)(c) (emphasis added). Respondent chose to focus on the words “wells started” and thus, by substituting “spudded”, choosing a point in time when a drill bit actually breaks the ground. If “wells started” were the entire statutory text, and “started” means “spudded”, then Respondents would be correct. However, the word “started” is not statutorily defined and Petitioner could not find legal support, either in general definitions of those customarily used in the oil and gas industry where the word “started” means “spudded” and concludes that there is none.

The word “start” has different meanings depending on the context of its use. Webster’s Encyclopedic Dictionary of the English Language, Delux Edition, 1990, contains various definitions and uses of the word, which include, inter alia: “to experience the first stage of [something] for the first time or after a period of not experiencing it”; to perform or do the first stages of [an action, course, etc.] for the first time or after a period of not performing or doing it”; “to cause [someone] to become engaged in a specific course of action...” (emphasis added). In certain situations,

something can even start “after a period of not” experiencing it performing it or doing it according to the plain meaning of the word “start”. *Id.* Obviously, one can start something once, and then, start it again after some delay. Petitioner submitted to Respondents that the actual definition of “start” alone was of little help in addressing the issue on appeal. The relevant question for the operative statute becomes when does a gas well like the Horsehead Point 18-44 natural gas well start.

Respondents cited to the case of *Vickers v. Peaker*, 300 S.W.2d 29 (Ark. 1957) in choosing to have the word “started” mean “spudded”. However, this case highlights the ambiguity of the term. It points out that a well can “start” at numerous points of time including, but not limited to, (a) when a person decides to drill the well at a particular location, or (b) when the well site is surveyed, or (c) when archeological clearance is made, or (d) when environmental requirements are satisfied, or (e) when the drilling permit is approved by the appropriate governmental authorities, or (f) when dirt work begins on the drill site, or (g) when the well is spudded, or (h) when the well actually begins commercial production of oil or gas. *See Id.* at 32. Respondents own case cited in its decision shows that the word “started” is ambiguous. Respondents therefore arbitrarily chose to make “started” mean “spudded” by choosing one of the points in the life of an oil or gas well where the well could start.

Start has many meanings in the oil and gas industry. Start can refer to the flowing of hydrocarbons. The New Mexico Supreme Court noted that turnkey contracts in the oil and gas industry involve agreements where wells are completed, placed into production

and turned over in a state ready to start flowing hydrocarbons into tanks. *Total Drilling Co. v. Abraham*, 328 P.2d 1083, 1091 (N.M. 1958). In *Boyce v. Dundee Healdton Sand Unit*, 560 P.2d 234 (Okla. Civ. App. 1975), wells started producing water rather than oil. Cases have also connected started with production. In the case of *Musgrave v. Musgrave*, 103 SE 302, 311 (W.Va. 1920), the West Virginia court declared that the landlord-tenant relationship with oil and gas leases continued despite the starting of production from a well, suggesting that the starting of production is a crucial moment in the timeline of successful well development. Phases of oil and gas leases also start based on the beginning of production or the level of production. *Palmer v. Bill Gallagher Enterprises, L.L.C.*, 240 P.3d 592, 592 (Kan. App. 2010).

The Tax Commission and Division have overlooked an initial draft of House Bill No. 110 which actually contained the word “spudded” in the exact place where the word “started” is in the current statute; however, this word was specifically removed before the bill was presented. If the statute was unambiguous and the state legislature intended for the word “started” to mean “spudded”, the word “spudded” would not have been specifically removed from the statute. Therefore, it is entirely reasonable that the word “started” was purposely intended not to mean “spudded”. By holding that the word “started” means “spudded”, Respondents have gone contrary to legislative intent and replaced the word “started” with the one word that the legislature did not intend to be used in the bill.

Moreover, other courts have ruled in the context of when an oil or gas well started that “started” and “spudded” are not synonymous. In the case of *Hilliard v. Franzeim*, 180 So.2d 746 (La. 1965), Franzheim contended that Hilliard’s contractual obligation to purchase an overriding royalty, which was conditioned on a well “to be started” within ninety days, meant that the well must be “spudded” within such period. Ruling against Franzheim and in favor of Hilliard, the court distinguished the terms, stating:

We find no merit in the defendant’s contention that the terms “started and “spudded” in the agreement were intended to be synonymous, so that the defendant was not obligated to buy the royalty unless the well was “spudded” in within the ninety days.

...the term to “spud in” has a well-defined meaning in the oil industry as the first boring of the hole in the ground, that is, the first actual penetration of the earth with a drilling bit; it has a distinct meaning different from other terms of the industry, such as to “commence to drill”, which refer to the first operations on the land preliminary to the actual drilling or supping in (citing numerous authorities omitted herein).

180 So.2d at 747.

Simply stated, in the general definitions and also in oil and gas industry definitions, the words “wells started” have no plain meaning and are ambiguous. Consequently, under the guidance of *ExxonMobil*, supra, this Court must reject Respondents’ assertion that “started” unambiguously means “spudded”, and consider the context of the words in the entire statute, and if they are still susceptible to multiple interpretations, consider the legislative history.

Petitioner submits that the reliance of Respondents on similar statutes of other jurisdictions to substitute the word “started” with “spudded” is also misplaced.

Respondents cite the tax codes of Texas and Alabama to somehow support its argument that “wells started” means “wells spudded”; however, a careful review of those statutes reveals that those respective legislatures actually used the word “spudded” in the statutory text to qualify a well for severance tax credits. Of course a statute which uses the word “spudded” will relate to the time a well is spudded. Utah’s statute, conversely, does not use the word “spudded”.

Furthermore, it is axiomatic and a long standing view that the local statute governs the meaning of oil and gas production tax in each state. See Lee Hill, State Taxation of Oil and Gas, 33 Texas L. Rev. 854 (1955); John H. Tippet, Property Taxation of Oil and Gas Interests, 24 Rocky Mt. L. Rev. 170 (1952). What Texas or Alabama do has little or no relevance to the interpretations of the Utah tax statutes, particularly as in this case where the words used are completely different. The cases cited by Respondent to support its “wells spudded” argument are also distinguishable from application because they simply offer no real guidance; neither the Utah tax statute nor the words “wells started” were ever at issue in any of them.

The Utah State Tax Commission cited *Parson Asphalt Products, Inc. v. Utah State Tax Commission*, 617 P.2d 397, 398 (Utah 1980) in which this Court stated:

Even though taxing statutes should generally be construed favorable to the taxpayer and strictly against the taxing authority, the reverse is true for exemptions. Statutes which provide exemptions should be strictly construed, and one who so claims has the burden of showing his entitlement to the exemption.

However, the Utah Supreme Court stated in the very next sentence of that case, “Notwithstanding the foregoing, there is also to be considered the over-arching principle, applicable to all statutes, that they should be construed and applied in accordance with the intent of the legislature and the purpose sought to be accomplished.” *Id.*

As this Court stated, ambiguity exists when there “is capable of more than one reasonable interpretation because of uncertain meanings of terms, missing terms, or other facial deficiencies”. *Wilson v. Johnson*, 2010 UT App 137, 234 P.3d 1156, 1162 (Utah App. 2010).

Based on the Tax Commission’s own cases cited, the fact that the decision was not unanimous and the various definitions which the word “started” can have, “started” cannot be unambiguous as asserted by the Respondents and the Court must look to the legislative intent for the statute’s meaning.

## **PART II**

### **Legislative Intent Suggests that Commercial “Production” of the Well is the Operative Event for the Tax Exemption.**

The language of the Utah statute relevant to this case was first enacted through House Bill No. 110 (“H.B. 110” herein) which continued the prior law of taxing the value of oil and gas from producing wells. Utah Code Ann. §59-5-102 & 103. H.B. 110, introduced in the General Session of 1990, however, had a particular purpose which can be gleaned from its title of “Severance Tax Incentives for Petroleum Industry Recovery”.

The Division referred to Senate Bill No.51 to support its argument that the petroleum industry incentives are aimed at drilling and not production. This bill, however, was never enacted into law and is not the statute in question. Granted that drilling a well is necessary to creating a producing well, the obvious purpose of the severance tax legislation is to tax production and not tax drilling. This interpretation was clearly made by the Office of the Legislative Fiscal Analysis (the "Office") when reporting on the potential fiscal impact of H.B. 110 to the legislature. (Addendum D). "The fiscal impact of this bill would be to reduce the oil and gas severance tax collected by the state," analyzed the Office. (Addendum D). Additionally, the Office made it clear that "The purpose of the above changes in the severance tax is to stimulate oil production in the State." (Addendum D).

H.B. 110 did many things, but its obvious purpose was to incentivize an ailing oil and gas industry in the State of Utah. It added new definitions for "Development wells" and for "Wildcat wells" which clearly refer only to "producing" wells, see Utah Code Ann. §59-5-101 (1) and (14) respectively. It has been held that the term "producing well" does not include a well that has discovered oil and gas but does not produce either. *Rogers v. Osborn*, 152 Tex. 540, 261 S.W.2d 311 (1953). The severance tax is only applicable to oil and gas which is "produced" from a well. Utah Code Ann. §59-5-102(1). Petitioner submits that these distinctions are important in understanding the complete statutory context, and because common sense dictates that the primary incentive for the oil and gas producers, and also for the State of Utah, is rooted in the production of oil and

gas, not the spudding, drilling, testing or completing of a well. If a well is drilled but never produced, there has never been a taxable severance of the minerals from the ground and therefore, no tax of the severance. A well does not simply qualify for the severance tax holiday when it is spudded. It qualifies only when it is producing and therefore becomes subject to severance taxes as evidenced by harmonizing the clear language of the severance tax statute as required by *ExxonMobil*, supra. See also, *State v. Bluth*, 53 P3 210 (Utah 2002) (if the Supreme Court finds a statutory provision that causes doubt or uncertainty in its application, the Court must analyze the act in its entirety and harmonize its provisions in accordance with legislative intent and purpose).

Petitioner submits that “production” is the operative word in defining when a well “started”, e.g. that “production for development wells”, as opposed to merely “wells” is the class of words forming the adjective to define and qualify the verb “started” in this statutory context. Indeed the Utah legislature could have used the word “spudded” or “spud date” instead of “started” but expressly chose not to do so. By elimination of the word “spudded” from the exact place in the statutory text where “started” was inserted, it seems obvious, if not conclusive, that the legislature did not intend the word “started” to mean when the drill bit turns to the right in the ground as advocated by Respondents.

Based on the foregoing, Petitioner submits that it is a fair and accurate interpretation of the relevant statute to conclude that a severance tax holiday is provided for wells where the taxable (or commercial) production started after January 1, 1990. A well does not qualify for the tax holiday unless it is capable of producing, and cannot be



taxed until it is actually producing and the oil and gas is sold or deemed sold. Utah Code Ann. §59-5-102(1). The legislature wanted new drilling to occur, but it also wanted to increase production of oil and gas in Utah. The legislators must have been aware of that during the 1989 oil and gas industry recession as many wells capable of production (such as the subject Well) were “shut in” because it was not economical to produce them for various reasons. The word “production” means marketable oil or gas. *Garcia v. King*, 139 Tex. 578, 164 S.W.2d 509 (Tex. 1942). As noted above, the amended note to the management and fiscal analysis (dated February 2, 1990) states, “The purpose of the above changes in the severance tax is to stimulate oil production in the State”(emphasis added).


Additionally, as a practical matter, the statute accomplished its designs and intent through Petitioner by having a well which had been shut-in for over twenty years begin to produce hydrocarbons. Petitioner constructed a natural gas gathering system pipeline to the Well at a cost of over \$900,000, employed citizens of the State of Utah to construct the system, employs staff to monitor the well and interpret data from the well head, employs individuals to market the hydrocarbons from the well etc. This work has not only supported production in the state and created jobs but has also provided tax revenue and economic benefits to the State Utah which would not have existed had the well remained shut-in. To interpret the statute as Respondents suggest would create the opposite effect for which the legislation was intended; it would create a disincentive to produce oil or gas from shut-in wells which have never been put into production such as

the Horsehead Point 18-44 at issue in this case. By having tax incentives available to companies willing to risk capital on decades' old projects, the statute "stimulate[d] oil production in the State" as the Office of the Legislative Fiscal Analysis had asserted.

### CONCLUSION

For the foregoing reasons, Petitioner, Summit Operating, LLC, respectfully prays that the ruling of the Utah State Tax Commission be reversed and Petitioner be allowed the six-month exemption from severance tax which it asserted.


DATED this 2<sup>nd</sup> day of AUGUST, 2011.

  
Jeremy C. Schwendiman (12652)  
Summit Operating, LLC  
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## CERTIFICATE OF SERVICE

I hereby certify that on this 3<sup>RD</sup> day of AUGUST, 2011, I caused a true and correct copy of the foregoing Brief of the Petitioner to be served via U.S. Mail, postage prepaid, upon each of the following:

Clark L. Snelson  
Assistant Attorney General  
160 E 300 S Fifth FLR.  
PO Box 140874  
Salt Lake City, Utah 84114

  
Jeremy C. Schwendiman

# ADDENDUM A

**59-1-601. District court jurisdiction.**

(1) In addition to the jurisdiction granted in Section 63G-4-402, beginning July 1, 1994, the district court shall have jurisdiction to review by trial de novo all decisions issued by the commission after that date resulting from formal adjudicative proceedings.

(2) As used in this section, "trial de novo" means an original, independent proceeding, and does not mean a trial de novo on the record.

(3) (a) In any appeal to the district court pursuant to this section taken after January 1, 1997, the commission shall certify a record of its proceedings to the district court.

(b) This Subsection (3) supercedes Section 63G-4-403 pertaining to judicial review of formal adjudicative proceedings.

## 59-5-101. Definitions.

As used in this part:

- (1) "Board" means the Board of Oil, Gas, and Mining created in Section 40-6-4.
- (2) "Coal-to-liquid" means the process of converting coal into a liquid synthetic fuel.
- (3) "Condensate" means those hydrocarbons, regardless of gravity, that occur naturally in the gaseous phase in the reservoir that are separated from the natural gas as liquids through the process of condensation either in the reservoir, in the wellbore, or at the surface in field separators.
- (4) "Crude oil" means those hydrocarbons, regardless of gravity, that occur naturally in the liquid phase in the reservoir and are produced and recovered at the wellhead in liquid form.
- (5) "Development well" means any oil and gas producing well other than a wildcat well.
- (6) "Division" means the Division of Oil, Gas, and Mining established under Title 40, Chapter 6.
- (7) "Enhanced recovery project" means:
  - (a) the injection of liquids or hydrocarbon or nonhydrocarbon gases directly into a reservoir for the purpose of:
    - (i) augmenting reservoir energy;
    - (ii) modifying the properties of the fluids or gases in a reservoir; or
    - (iii) changing the reservoir conditions to increase the recoverable oil, gas, or oil and gas through the joint use of two or more well bores; and
  - (b) a project initially approved by the board as a new or expanded enhanced recovery project on or after January 1, 1996.
- (8) (a) "Gas" means:
  - (i) natural gas;
  - (ii) natural gas liquids; or
  - (iii) any mixture of natural gas and natural gas liquids.

(b) "Gas" does not include solid hydrocarbons.
- (9) "Incremental production" means that part of production, certified by the Division of Oil, Gas, and Mining, which is achieved from an enhanced recovery project that would not have economically occurred under the reservoir conditions existing before the project and that has been approved by the division as incremental production.
- (10) "Natural gas" means those hydrocarbons, other than oil and other than natural gas liquids separated from natural gas, that occur naturally in the gaseous phase in the reservoir and are produced and recovered at the wellhead in gaseous form.
- (11) "Natural gas liquids" means those hydrocarbons initially in reservoir natural gas, regardless of gravity, that are separated in gas processing plants from the natural gas as liquids at the surface through the process of condensation, absorption, adsorption, or other methods.
- (12) (a) "Oil" means:
  - (i) crude oil;
  - (ii) condensate; or
  - (iii) any mixture of crude oil and condensate.

(b) "Oil" does not include solid hydrocarbons.
- (13) "Oil or gas field" means a geographical area overlying oil or gas structures. The boundaries of oil or gas fields shall conform with the boundaries as fixed by the Board and Division of Oil, Gas, and Mining under Title 40, Chapter 6, Board and Division of Oil, Gas, and

Mining.

(14) "Oil shale" means a group of fine black to dark brown shales containing bituminous material that yields petroleum upon distillation.

(15) "Operator" means any person engaged in the business of operating an oil or gas well, regardless of whether the person is:

- (a) a working interest owner;
- (b) an independent contractor; or
- (c) acting in a capacity similar to Subsection (15)(a) or (b) as determined by the commission by rule made in accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act.

(16) "Owner" means any person having a working interest, royalty interest, payment out of production, or any other interest in the oil or gas produced or extracted from an oil or gas well in the state, or in the proceeds of this production.

(17) (a) Subject to Subsections (17)(b) and (c), "processing costs" means the reasonable actual costs of processing oil or gas to remove:

- (i) natural gas liquids; or
- (ii) contaminants.
- (b) If processing costs are determined on the basis of an arm's-length contract, processing costs are the actual costs.

(c) (i) If processing costs are determined on a basis other than an arm's-length contract, processing costs are those reasonable costs associated with:

- (A) actual operating and maintenance expenses, including oil or gas used or consumed in processing;
- (B) overhead directly attributable and allocable to the operation and maintenance; and
- (C) (I) depreciation and a return on undepreciated capital investment; or
- (II) a cost equal to a return on the investment in the processing facilities as determined by the commission.

(ii) Subsection (17)(c)(i) includes situations where the producer performs the processing for the producer's product.

(18) "Producer" means any working interest owner in any lands in any oil or gas field from which gas or oil is produced.

(19) "Recompletion" means any downhole operation that is:

- (a) conducted to reestablish the producibility or serviceability of a well in any geologic interval; and
- (b) approved by the division as a recompletion.

(20) "Research and development" means the process of inquiry or experimentation aimed at the discovery of facts, devices, technologies, or applications and the process of preparing those devices, technologies, or applications for marketing.

(21) "Royalty interest owner" means the owner of an interest in oil or gas, or in the proceeds of production from the oil or gas who does not have the obligation to share in the expenses of developing and operating the property.

(22) "Solid hydrocarbons" means:

- (a) coal;
- (b) gilsonite;
- (c) ozocerite;
- (d) elaterite;
- (e) oil shale;

- (f) tar sands; and
- (g) all other hydrocarbon substances that occur naturally in solid form.
- (23) "Stripper well" means:
  - (a) an oil well whose average daily production for the days the well has produced has been 20 barrels or less of crude oil a day during any consecutive 12-month period; or
  - (b) a gas well whose average daily production for the days the well has produced has been 60 MCF or less of natural gas a day during any consecutive 90-day period.
- (24) "Tar sands" means impregnated sands that yield mixtures of liquid hydrocarbon and require further processing other than mechanical blending before becoming finished petroleum products.
- (25) (a) Subject to Subsections (25)(b) and (c), "transportation costs" means the reasonable actual costs of transporting oil or gas products from the well to the point of sale.
  - (b) If transportation costs are determined on the basis of an arm's-length contract, transportation costs are the actual costs.
  - (c) (i) If transportation costs are determined on a basis other than an arm's-length contract, transportation costs are those reasonable costs associated with:
    - (A) actual operating and maintenance expenses, including fuel used or consumed in transporting the oil or gas;
    - (B) overhead costs directly attributable and allocable to the operation and maintenance; and
    - (C) depreciation and a return on undepreciated capital investment.
  - (ii) Subsection (25)(c)(i) includes situations where the producer performs the transportation for the producer's product.
  - (d) Regardless of whether transportation costs are determined on the basis of an arm's-length contract or a basis other than an arm's-length contract, transportation costs include:
    - (i) carbon dioxide removal;
    - (ii) compression;
    - (iii) dehydration;
    - (iv) gathering;
    - (v) separating;
    - (vi) treating; or
    - (vii) a process similar to Subsections (25)(d)(i) through (vi), as determined by the commission by rule made in accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act.
- (26) "Tribe" means the Ute Indian Tribe of the Uintah and Ouray Reservation.
- (27) "Well or wells" means any extractive means from which oil or gas is produced or extracted, located within an oil or gas field, and operated by one person.
- (28) "Wildcat well" means an oil and gas producing well which is drilled and completed in a pool, as defined under Section 40-6-2, in which a well has not been previously completed as a well capable of producing in commercial quantities.
- (29) "Working interest owner" means the owner of an interest in oil or gas burdened with a share of the expenses of developing and operating the property.
- (30) (a) "Workover" means any downhole operation that is:
  - (i) conducted to sustain, restore, or increase the producibility or serviceability of a well in the geologic intervals in which the well is currently completed; and
  - (ii) approved by the division as a workover.
- (b) "Workover" does not include operations that are conducted primarily as routine maintenance or to replace worn or damaged equipment.



**59-5-102. Severance tax -- Rate -- Computation -- Annual exemption -- Tax credit -- Tax rate reduction -- Study by Revenue and Taxation Interim Committee.**

(1) (a) Subject to Subsection (1)(b), a person owning an interest in oil or gas produced from a well in the state, including a working interest, royalty interest, payment out of production, or any other interest, or in the proceeds of the production of oil or gas, shall pay to the state a severance tax on the basis of the value determined under Section 59-5-103.1 of the oil or gas:

- (i) produced; and
- (ii) (A) saved;
- (B) sold; or
- (C) transported from the field where the substance was produced.

(b) This section applies to an interest in oil or gas produced from a well in the state or in the proceeds of the production of oil or gas produced from a well in the state except for:

- (i) an interest of the United States in oil or gas or in the proceeds of the production of oil or gas;
- (ii) an interest of the state or a political subdivision of the state in oil or gas or in the proceeds of the production of oil or gas; or
- (iii) an interest of an Indian or Indian tribe as defined in Section 9-9-101 in oil or gas or in the proceeds of the production of oil or gas produced from land under the jurisdiction of the United States.

(2) (a) Subject to Subsection (2)(d), the severance tax rate for oil is as follows:

- (i) 3% of the value of the oil up to and including the first \$13 per barrel for oil; and
- (ii) 5% of the value of the oil from \$13.01 and above per barrel for oil.

(b) Subject to Subsection (2)(d), the severance tax rate for natural gas is as follows:

- (i) 3% of the value of the natural gas up to and including the first \$1.50 per MCF for gas; and
- (ii) 5% of the value of the natural gas from \$1.51 and above per MCF for gas.

(c) Subject to Subsection (2)(d), the severance tax rate for natural gas liquids is 4% of the value of the natural gas liquids.

(d) (i) On or before December 15, 2004, the Office of the Legislative Fiscal Analyst and the Governor's Office of Planning and Budget shall prepare a revenue forecast estimating the amount of revenues that:

(A) would be generated by the taxes imposed by this part for the calendar year beginning on January 1, 2004 had 2004 General Session S.B. 191 not taken effect; and

(B) will be generated by the taxes imposed by this part for the calendar year beginning on January 1, 2004.

(ii) Effective on January 1, 2005, the tax rates described in Subsections (2)(a) through (c) shall be:

(A) increased as provided in Subsection (2)(d)(iii) if the amount of revenues estimated under Subsection (2)(d)(i)(B) is less than the amount of revenues estimated under Subsection (2)(d)(i)(A); or

(B) decreased as provided in Subsection (2)(d)(iii) if the amount of revenues estimated under Subsection (2)(d)(i)(B) is greater than the amount of revenues estimated under Subsection (2)(d)(i)(A).

(iii) For purposes of Subsection (2)(d)(ii):

(A) subject to Subsection (2)(d)(iv)(B):

(I) if an increase is required under Subsection (2)(d)(ii)(A), the total increase in the tax rates shall be by the amount necessary to generate for the calendar year beginning on January 1, 2005 revenues equal to the amount by which the revenues estimated under Subsection (2)(d)(i)(A) exceed the revenues estimated under Subsection (2)(d)(i)(B); or

(II) if a decrease is required under Subsection (2)(d)(ii)(B), the total decrease in the tax rates shall be by the amount necessary to reduce for the calendar year beginning on January 1, 2005 revenues equal to the amount by which the revenues estimated under Subsection (2)(d)(i)(B) exceed the revenues estimated under Subsection (2)(d)(i)(A); and

(B) an increase or decrease in each tax rate under Subsection (2)(d)(ii) shall be in proportion to the amount of revenues generated by each tax rate under this part for the calendar year beginning on January 1, 2003.

(iv) (A) The commission shall calculate any tax rate increase or decrease required by Subsection (2)(d)(ii) using the best information available to the commission.

(B) If the tax rates described in Subsections (2)(a) through (c) are increased or decreased as provided in this Subsection (2)(d), the commission shall mail a notice to each person required to file a return under this part stating the tax rate in effect on January 1, 2005 as a result of the increase or decrease.

(3) If oil or gas is shipped outside the state:

(a) the shipment constitutes a sale; and

(b) the oil or gas is subject to the tax imposed by this section.

(4) (a) Except as provided in Subsection (4)(b), if the oil or gas is stockpiled, the tax is not imposed until the oil or gas is:

(i) sold;

(ii) transported; or

(iii) delivered.

(b) Notwithstanding Subsection (4)(a), if oil or gas is stockpiled for more than two years, the oil or gas is subject to the tax imposed by this section.

(5) A tax is not imposed under this section upon:

(a) stripper wells, unless the exemption prevents the severance tax from being treated as a deduction for federal tax purposes;

(b) the first 12 months of production for wildcat wells started after January 1, 1990; or

(c) the first six months of production for development wells started after January 1, 1990.

(6) (a) Subject to Subsections (6)(b) and (c), a working interest owner who pays for all or part of the expenses of a recompletion or workover may claim a nonrefundable tax credit equal to 20% of the amount paid.

(b) The tax credit under Subsection (6)(a) for each recompletion or workover may not exceed \$30,000 per well during each calendar year.

(c) If any amount of tax credit a taxpayer is allowed under this Subsection (6) exceeds the taxpayer's tax liability under this part for the calendar year for which the taxpayer claims the tax credit, the amount of tax credit exceeding the taxpayer's tax liability for the calendar year may be carried forward for the next three calendar years.

(7) A 50% reduction in the tax rate is imposed upon the incremental production achieved from an enhanced recovery project.

(8) The taxes imposed by this section are:

(a) in addition to all other taxes provided by law; and

(b) delinquent, unless otherwise deferred, on June 1 next succeeding the calendar year when the oil or gas is:

- (i) produced; and
- (ii) (A) saved;
- (B) sold; or
- (C) transported from the field.

(9) With respect to the tax imposed by this section on each owner of oil or gas or in the proceeds of the production of those substances produced in the state, each owner is liable for the tax in proportion to the owner's interest in the production or in the proceeds of the production.

(10) The tax imposed by this section shall be reported and paid by each producer that takes oil or gas in kind pursuant to agreement on behalf of the producer and on behalf of each owner entitled to participate in the oil or gas sold by the producer or transported by the producer from the field where the oil or gas is produced.

(11) Each producer shall deduct the tax imposed by this section from the amounts due to other owners for the production or the proceeds of the production.

(12) (a) The Revenue and Taxation Interim Committee shall review the applicability of the tax provided for in this chapter to coal-to-liquids, oil shale, and tar sands technology on or before the October 2011 interim meeting.

(b) The Revenue and Taxation Interim Committee shall address in its review the cost and benefit of not applying the tax provided for in this chapter to coal-to-liquids, oil shale, and tar sands technology.

(c) The Revenue and Taxation Interim Committee shall report its findings and recommendations under this Subsection (12) to the Legislative Management Committee on or before the November 2011 interim meeting.

**59-5-103.1. Valuation of oil or gas -- Deductions.**

(1) (a) For purposes of the tax imposed under Section 59-5-102 and subject to Subsection (2), the value of oil or gas shall be determined at the first point closest to the well at which the fair market value for the oil or gas may be determined by:

- (i) a sale pursuant to an arm's-length contract; or
- (ii) for a sale other than a sale described in Subsection (1)(a)(i), comparison to other sales of oil or gas.

(b) For purposes of determining the fair market value of oil or gas under Subsection (1), a person subject to a tax under Section 59-5-102 may deduct:

- (i) processing costs from the value of:
  - (A) oil; or
  - (B) gas; and
- (ii) (A) except as provided in Subsection (1)(b)(ii)(B), transportation costs from the value of:
  - (I) oil; and
  - (II) gas; and
- (B) notwithstanding Subsection (1)(b)(ii)(A), the deduction for transportation costs may not exceed 50% of the value of the:

- (I) oil; or
  - (II) gas.

(2) Subsection (1)(a)(ii) applies to a sale of oil or gas between:

- (a) a parent company and a subsidiary company;
- (b) companies wholly owned or partially owned by a common parent company; or
- (c) companies otherwise affiliated.

### 78A-3-102. Supreme Court jurisdiction.

(1) The Supreme Court has original jurisdiction to answer questions of state law certified by a court of the United States.

(2) The Supreme Court has original jurisdiction to issue all extraordinary writs and authority to issue all writs and process necessary to carry into effect its orders, judgments, and decrees or in aid of its jurisdiction.

(3) The Supreme Court has appellate jurisdiction, including jurisdiction of interlocutory appeals, over:

- (a) a judgment of the Court of Appeals;
- (b) cases certified to the Supreme Court by the Court of Appeals prior to final judgment by the Court of Appeals;
- (c) discipline of lawyers;
- (d) final orders of the Judicial Conduct Commission;
- (e) final orders and decrees in formal adjudicative proceedings originating with:
  - (i) the Public Service Commission;
  - (ii) the State Tax Commission;
  - (iii) the School and Institutional Trust Lands Board of Trustees;
  - (iv) the Board of Oil, Gas, and Mining;
  - (v) the state engineer; or
  - (vi) the executive director of the Department of Natural Resources reviewing actions of the Division of Forestry, Fire, and State Lands;
- (f) final orders and decrees of the district court review of informal adjudicative proceedings of agencies under Subsection (3)(e);
- (g) a final judgment or decree of any court of record holding a statute of the United States or this state unconstitutional on its face under the Constitution of the United States or the Utah Constitution;
- (h) interlocutory appeals from any court of record involving a charge of a first degree or capital felony;
- (i) appeals from the district court involving a conviction or charge of a first degree felony or capital felony;
- (j) orders, judgments, and decrees of any court of record over which the Court of Appeals does not have original appellate jurisdiction; and
- (k) appeals from the district court of orders, judgments, or decrees ruling on legislative subpoenas.

(4) The Supreme Court may transfer to the Court of Appeals any of the matters over which the Supreme Court has original appellate jurisdiction, except:

- (a) capital felony convictions or an appeal of an interlocutory order of a court of record involving a charge of a capital felony;
- (b) election and voting contests;
- (c) reapportionment of election districts;
- (d) retention or removal of public officers;
- (e) matters involving legislative subpoenas; and
- (f) those matters described in Subsections (3)(a) through (d).

(5) The Supreme Court has sole discretion in granting or denying a petition for writ of certiorari for the review of a Court of Appeals adjudication, but the Supreme Court shall review those cases certified to it by the Court of Appeals under Subsection (3)(b).

(6) The Supreme Court shall comply with the requirements of Title 63G, Chapter 4, Administrative Procedures Act, in its review of agency adjudicative proceedings.

# ADDENDUM B

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BEFORE THE UTAH STATE TAX COMMISSION

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SUMMIT OPERATING, LLC,

Petitioner,

v.

AUDITING DIVISION OF THE  
UTAH STATE TAX COMMISSION,

Respondent.

**ORDER GRANTING AUDITING  
DIVISION'S MOTION FOR  
SUMMARY JUDGMENT AND  
DENYING PETITIONER'S CROSS-  
MOTION FOR SUMMARY  
JUDGMENT**

Appeal No. 10-0119

Account No. N2315

Tax Type: Severance Tax

Audit Period: 01/01/08 – 12/31/08

Judge: Chapman

**Presiding:**

D'Arcy Dixon Pignanelli, Commissioner

Kerry R. Chapman, Administrative Law Judge

**Appearances:**

For Petitioner: Mr. Thomas W. Bachtell, Attorney

For Respondent: Mr. Clark L. Snelson, Attorney

STATEMENT OF THE CASE

On July 22, 2010, Auditing Division ("Division") submitted a Motion for Summary Judgment and a Memorandum in Support of its Motion for Summary Judgment. In its Motion for Summary Judgment, the Division asks the Commission to find that a natural gas well does not qualify for the six-month exemption from severance tax allowed under UCA §59-5-102(5)(c) (2008) where drilling, or "spudding," of the well began in 1983. Section 59-5-102(5)(c) provides a six-month exemption for "the first six months of production for development wells started after January 1, 1990." The Division specifically asks the Commission to find that the word "started" in Section 59-5-102(5)(c) refers to the date on which drilling begins on a well.

On August 3, 2010, Summit Operating, LLC ("Summit" or "taxpayer") submitted Petitioner's Cross-Motion for Summary Judgment and a Memorandum in Opposition to Respondent's Motion for Summary Judgment and in Support of its Cross-Motion for Summary Judgment. In its Cross-



Motion for Summary Judgment, the taxpayer asks the Commission to find that a natural gas well qualifies for the six-month exemption from severance tax allowed under Section 59-5-102(5)(c) where “taxable production” (i.e., production that is subject to severance taxation unless an exemption otherwise applies) did not begin until 2008. Specifically, the taxpayer asks the Commission find that the word “started” in Section 59-5-102(5)(c) refers to the date on which taxable production begins.

On August 16, 2010, the Division submitted its Memorandum in Opposition to Petitioner’s Cross-Motion for Summary Judgment. A hearing was held on August 17, 2010, at which time both parties had an opportunity to present oral arguments on their respective motions.

#### STATEMENT OF UNDISPUTED FACTS

1. On December 17, 2009, the Division issued a Statutory Notice to the taxpayer for the period January 1, 2008 through December 31, 2008, in which it imposed additional severance tax in the amount of \$66,916.43 and interest (calculated through January 16, 2010) in the amount of \$2,089.99, for a total assessment of \$69,006.42.

2. Part of the Division’s assessment concerned the taxpayer’s claim of the six-month exemption provided in Section 59-5-102(5) for one of its natural gas wells identified as entity number 6031 (the “Well”). The Division determined that the Well did not qualify for the exemption that the taxpayer had claimed and assessed severance tax accordingly.

3. The “spud date” of the Well (i.e., the date when the drill bit pierced the earth) is August 28, 1983.

4. The Well was “completed” and capable of producing natural gas on August 16, 1984. The completion process included “testing” the Well, part of which involved a “flow test” where natural gas was allowed to flow to measure production. A flow test was conducted on the Well on or about August 16, 1984.

5. The Well was shut-in on August 20, 1984, and remained shut-in for many years until the taxpayer purchased it. The Well is in a remote location. In 2007, the taxpayer constructed a natural gas gathering system pipeline to the Well at a cost of over \$900,000.

6. On January 7, 2008, the taxpayer began to produce natural gas from the Well that is subject to the severance tax unless an exemption applies.

7. Effective January 1, 1984, the Legislature enacted UCA §59-5-67(6) (1984), which provided an exemption from the occupation tax (a precursor to the severance tax). Subsection 59-5-67(6) provided, as follows: “An exemption from the payment of occupation tax imposed by this article is allowed for a period of six months following the first day of production. Such exemption shall apply only to wells started after the January 1, 1984 effective date of this act.”

8. In 1990, the Legislature passed House Bill No. 110 (“HB 110”), in which it provided an exemption from severance tax. Effective January 1, 1990, Section §59-5-102(2) (1990) provided, as follows in pertinent part:

(2) No tax is imposed upon:

....

(c) the first six months of production for wells started after January 1, 1984, but before January 1, 1990;

(d) the first 12 months of production for wildcat wells started after January 1, 1990; or

(e) the first six months of production for development wells started after January 1, 1990.

9. The audio record of the House Floor Debate for HB 110 is found at <http://le.utah.gov>. Utah HB 110, Gen. Sess. (Feb. 20, 1990). This record indicates that Representative Adams sponsored the bill in response to severe economic conditions affecting the oil and gas producing areas of Utah in 1990. He mentioned that the cost to drill a well in Utah was more than double the cost to drill a well in nearby states. He stated that the bill provisions, which include the “holiday” exemptions provided in Subsection 59-5-102(2) (1990), were intended to attract companies to produce more oil (and gas) in Utah.

10. In the enrolled copy of HB 110, the Legislature provided that the holiday exemptions of Subsection 59-5-102(2) applied to production for wells “**started** after January 1, 1990” (emphasis added). The same language was found in drafts of the bills dated January 12, 1990, December 27, 1989, December 18, 1989, and November 24, 1989. The taxpayer, however, provided an undated draft of the bill in which the word “spudded” appeared instead of the word “started.” In this draft, the holiday exemption applied to production for wells “**spudded** after January 1, 1990” (emphasis added).

11. In 2004, the Legislature deleted Subsection 59-5-102(2)(c) (1990), which had provided an exemption from severance tax on “the first six months of production for wells started after January 1, 1984, but before January 1, 1990[.]”

#### APPLICABLE LAW

1. Under rule 56(c) of the Utah Rules of Civil Procedure, a summary judgment shall be rendered “if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” Facts and inferences to be drawn by the Commission in the summary judgment proceeding must be viewed in the light most favorable to the party opposing the summary judgment. *See Broadwater v. Old Republic Sur.*, 854 P.2d 527 (Utah 1993).

2. Section 59-5-101(2008)<sup>1</sup> provides severance tax definitions, as follows in pertinent part:

(5) “Development well” means all oil and gas producing well other than a wildcat well.

.....  
(27) “Well or wells” means any extractive means from which oil or gas is produced or extracted, location within an oil or gas field, and operated by one person.

(28) “Wildcat well” means an oil and gas producing well which is drilled and completed in a pool, as defined under Section 40-6-2, in which a well has not been previously completed as a well capable of producing in commercial quantities.

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<sup>1</sup> The 2008 version of Section 59-5-102 is the law that applies to this case. Previous versions of this law appear in the Statement of Undisputed Facts section of this decision only to assist, if needed, in interpreting the 2008 law.

3. Section 59-5-102(5) provides for certain exemptions from severance tax, as follows in pertinent part:

(5) A tax is not imposed upon:

.....

(b) the first 12 months of production for wildcat wells started after January 1, 1990; or

(c) the first six months of production for development wells started after January 1, 1990.

#### DISCUSSION

Is there any genuine issue as to a material fact that would preclude the Commission from answering the legal issue before it, specifically how to interpret the word “started” in Section 59-5-102(5)(c) (2008). The taxpayer indicated in its brief and at the hearing that it is seeking a six-month exemption for the Well at issue. Subsection 59-5-102(5)(c) provides a six-month severance tax exemption for “development wells.” However, taxpayer’s Exhibit 4 suggests that the Well at issue may be a “wildcat well.” Subsection 59-5-102(5)(b) provides a twelve-month severance tax exemption for “wildcat wells.” The phrase “started by January 1, 1990” is found in both Subsections 102(5)(b) and 102(5)(c). As a result, the Commission’s interpretation of the word “started” will have the same effect for both exemptions and will have the same impact on the Well at issue, regardless of whether it is a development well or a wildcat well. Accordingly, there is no genuine issue as to a material fact that would preclude the Commission from deciding the legal issue.

In *Parson Asphalt Products, Inc. v. Utah State Tax Commission*, 617 P.2d 397 (Utah 1980), the Utah Supreme Court explained that exemptions are narrowly construed and that the person seeking the exemption has the burden to show that they fall within the scope of the exemption. Subsection 102(5)(c) provides a severance tax exemption for “the first six months of production for development wells started after January 1, 1990.” The taxpayer asks the Commission to find that “started” refers to the date that taxable production begins at a well. The Division asks the Commission to find that “started” refers to the date that the drilling, or spudding, of the well begins. Critical to the

Commission's interpretation is whether the word "started" modifies the word "production" or the word "wells."

The majority are not convinced that the taxpayer's Well qualifies for the exemption. The majority believe that word "started" modifies the word "wells," the word it immediately follows, and does not modify the word "production." As a result, the majority does not agree with the taxpayer's conclusion that all wells whose production started after January 1, 1990 qualify for exemption. The majority agrees with the Division that the drilling, or spudding, of a well must have begun after January 1, 1990 in order for the well to have been "started after January 1, 1990" and for it to qualify for the exemption.<sup>2</sup>

The majority recognize that one of a number of drafts of HB 110 used the word "spudded" instead of the word "started." However, the majority does not find this fact to show that the Legislature did not intend the word "started" to mean "spudded" for purposes of the exemption. In conclusion, if a well is spudded after January 1, 1990, its production qualifies for a six-month exemption under Section 59-5-102(5)(c) (2008). In this appeal, the Well at issue was spudded in 1983. Accordingly, it does not qualify for a severance tax exemption under Subsection 102(5)(c).

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Kerry R. Chapman  
Administrative Law Judge

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<sup>2</sup> As an alternative, "started" could also be interpreted to refer to the first operations on the land preliminary to the actual drilling, in which case the word "started" would refer to events prior to the spud date. See *Vickers v. Peaker*, 300 SW.2d 29 (Ark. 1957) (in which the court ruled that a well was started prior to the spud date, referencing numerous pre-drilling events). However, the majority prefer not to interpret "started" to mean a date prior to the date on which a well was spudded.

DECISION AND ORDER

On the basis of the information presented by the parties, the Commission finds that the Section 59-5-102(5)(c) exemption only applies to wells that were spudded after January 1, 1990. Accordingly, the Commission grants the Division's Motion for Summary Judgment and denies the taxpayer's Cross-Motion for Summary Judgment. It is so ordered.

DATED this 6th day of January, 2011.



R. Bruce Johnson  
Commission Chair



Marc B. Johnson  
Commissioner



Michael J. Cragun  
Commissioner

DISSENT

I respectfully dissent from my colleagues.

The applicable law passed in 1990 with Substitute House Bill 110 reads "no tax is imposed on (e) the first six months of production for development wells started after January 1, 1990."

A development well is defined as an oil and gas producing well.

Analyst by the Office of Legislative Fiscal Analyst of Substitute House Bill 110 states, "The purpose of the above changes in the severance tax is to stimulate oil production in the State."<sup>3</sup>

On August 14, 1984 a minimal amount of natural gas was flared to test the subject well, and then the well was shut-in, as declared on August 20, 1984.<sup>4</sup> No more oil or gas was produced from the well following the one day test.

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<sup>3</sup> I take administrative notice of this record available to the public on the Utah Legislature website.

<sup>4</sup> Petitioner's exhibit four, which is a federal form filed with the State of Utah, Division of Oil, Gas and Mining.

The subject well was shut-in for 22 years. After the Petitioner acquired the well in May 2006, Petitioner invested \$900,000 to build a pipeline to transport oil and gas from the subject well to market. Once the Petitioner had the pipeline in place, the Petitioner was able to start the well into production, which it did on January 7, 2008.

A shut-in well is of no value to the State of Utah. It provides no jobs. A well in production can help fuel the economy which was also the intent of the bill as understood in listening to the audio of the legislative presentation of Substitute House Bill 110 (1990) on the floor of the House of Representatives by the sponsor Rep. Adams.

We must always look first to the intent of the law.

This is why the controlling word in the law is "production" and "start" modifies "production." The intent of the law was to get wells into production.

I hold the subject well being started into production met the intent of the law. I would have granted the credit for the first six months of production starting January 7, 2008.



D'Arcy Dixon Pignanelli  
Commissioner

**Notice of Appeal Rights:** You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §§59-1-601 et seq. and 63G-4-401 et seq.

KRC/10-0119.osj

Utah State Tax Commission  
USTC - Appeal  
Certificate of Mailing

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Craig Sandberg, Summit Operating LLC vs. Auditing Division

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10-0119

**Craig Sandberg**  
210 North 1950 West  
Salt Lake City, UT 84134

**Respondent**

**Clark L. Snelson**  
Assistant Attorney General 50 South Main, Suite 900  
SLC, UT 84144

**Attorney for Respondent**

**Thomas Bachtell**  
1245 E Brickyard Road STE 110  
SLC, UT 84106

**Attorney for Petitioner**

**Summit Operating LLC**  
Keith C Crandall 1245 Brickyard RD, STE 210  
Salt Lake City, UT 84106

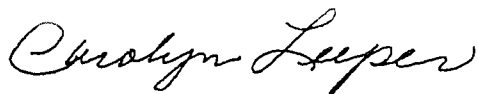
**Petitioner**

---

\*\*\*\* CERTIFICATION \*\*\*\*

I hereby certify that I mailed a copy of the foregoing document addressed to each of the above named parties.

\_\_\_\_ January 6, 2011 \_\_\_\_  
Date

  
\_\_\_\_\_  
Signature



# ADDENDUM C

February 2, 1990

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MANAGEMENT AND FISCAL ANALYSIS

SUBSTITUTE  
H. B. 110  
AMENDED NOTE

The fiscal impact of this bill would be to reduce the oil and gas severance tax collected by the State. There are three parts to the bill. The first part changes the severance tax rate from a flat rate to a graduated rate depending on the price of oil or gas. The second part gives a tax credit for "wildcat wells" and the third part gives a tax credit for recompletion or workover expenses.

It is estimated that the following impacts would apply to each part:

	<u>FY 1990</u>	<u>FY 1991</u>
Graduated rate	(\$725,000)	(\$2,900,000)
Wildcat Exemption	(12,500)	(50,000)
Workover Credit	<u>(625,000)</u>	<u>(2,500,000)</u>
Total	<u>(\$1,362,500)</u>	<u>(\$5,450,000)</u>

These amounts would reduce the Oil and Gas Severance Tax in the General Fund.

The above impact was estimated at \$20 per barrel. If the price drops to \$14 per barrel the loss would double, if the price increases to \$26 per barrel the loss would be cut in half.

The Tax Commission estimates that it would require one additional auditor to work with this program at an annual cost of \$50,000 from the General Fund.

The purpose of the above changes in the severance tax is to stimulate oil production in the State. It is impossible to estimate what impact these incentives will actually have on the oil and gas industry in Utah.

# ADDENDUM D

1 LEGISLATIVE GENERAL COUNSEL  
2 H. B. No.  
3 Approved for Filing \_\_\_\_\_  
4 Date \_\_\_\_\_  
5 (SEVERANCE TAX INCENTIVES FOR  
6 PETROLEUM INDUSTRY RECOVERY)  
7 1990  
8 GENERAL SESSION  
9 H. B. No. By \_\_\_\_\_  
10 \_\_\_\_\_  
11 \_\_\_\_\_  
12 AN ACT RELATING TO REVENUE AND TAXATION; ESTABLISHING GRADUATED OIL AND GAS  
13 SEVERANCE TAX RATES; GRANTING OIL AND GAS SEVERANCE TAX EXEMPTIONS  
14 AND CREDITS; AND PROVIDING RETROSPECTIVE OPERATION.  
15 THIS ACT AFFECTS SECTIONS OF UTAH CODE ANNOTATED 1953 AS FOLLOWS:  
16 AMENDS:  
17 59-5-101, AS LAST AMENDED BY CHAPTER 4, LAWS OF UTAH 1988  
18 Be it enacted by the Legislature of the state of Utah:  
19 Section 1. Section 59-5-101, Utah Code Annotated 1953, as last amended by  
20 Chapter 4, Laws of Utah 1988, is amended to read:  
21 59-5-101. (1) "Development wells" means all oil and gas producing wells  
22 other than wildcat wells.  
23 (2) "Division" means the Division of Oil, Gas and Mining created under  
24 section 40-6-15.  
25 ~~[14]~~ (3) "Gas" means natural gas or natural gas liquids or any mixture  
26 thereof, except it does not include solid hydrocarbons.

1       (a) "Natural gas" means those hydrocarbons, other than oil  
2       and other than natural gas liquids separated from natural gas,  
3       that occur naturally in the gaseous phase in the reservoir and  
4       are produced and recovered at the wellhead in gaseous form.

5       (b) "Natural gas liquids" means those hydrocarbons  
6       initially in reservoir natural gas, regardless of gravity, that  
7       are separated in gas processing plants from the natural gas as  
8       liquids at the surface through the process of condensation,  
9       absorption, adsorption, or other methods.

10       ~~[(2)]~~ (4) "Oil" means crude oil or condensate or any  
11       mixture thereof, except it does not include solid hydrocarbons.

12       (a) "Crude oil" means those hydrocarbons, regardless of  
13       gravity, that occur naturally in the liquid phase in the  
14       reservoir and are produced and recovered at the wellhead in  
15       liquid form.

16       (b) "Condensate" means those hydrocarbons, regardless of  
17       gravity, that occur naturally in the gaseous phase in the  
18       reservoir that are separated from the natural gas as liquids  
19       through the process of condensation either in the reservoir, in  
20       the wellbore, or at the surface in field separators.

21       ~~[(3)]~~ (5) "Oil or gas field" means a geographical area  
22       overlying oil or gas structures. The boundaries of such fields  
23       shall conform with the boundaries as fixed by the Board of Oil,  
24       Gas, and Mining under Chapter 6, Title 40.

25       ~~[(4)]~~ (6) "Owner" means any person having a working  
26       interest, royalty interest, payment out of production, or any

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1 other interest in the oil or gas produced or extracted from an  
2 oil or gas well in the state, or in the proceeds of this  
3 production.

4       ~~[(5)]~~ (7) "Producer" means any working interest owner in any  
5 lands in any oil or gas field from which gas or oil is produced.

6       (8) "Recompletion" means any completion in a new perforated  
7 interval or pool within an established wellbore and approved by  
8 the Division as a recompletion.

9       ~~[(6)]~~ (9) "Royalty interest owner" means the owner of an  
10 interest in oil or gas, or in the proceeds of production from  
11 them who does not have the obligation to share in the expenses of  
12 developing and operating the property.

13       ~~[(7)]~~ (10) "Solid hydrocarbons" means coal, gilsonite,  
14 ozocerite, elaterite, oil shale, tar sands, and all other  
15 hydrocarbon substances that occur naturally in solid form.

16       ~~[(8)]~~ (11) "Stripper well" means:

17       (a) an oil well whose average daily production for the days  
18 the well has produced has been 20 barrels or less of crude oil a  
19 day during any consecutive 12-month period; or

20       (b) a gas well whose average daily production for the days  
21 the well has produced has been 60 mcf or less of natural gas a  
22 day during any consecutive 90-day period.

23       ~~[(9)]~~ (12) "Well or wells" means any extractive means from  
24 which oil or gas is produced or extracted, located within an oil  
25 or gas field, and operated by one person.

1        ~~[(10)]~~ (13) "Wildcat wells" means oil and gas producing wells  
 2 which are drilled and completed in a "pool", as defined under  
 3 Section 40-6-2, in which a well has not been previously completed  
 4 as a well capable of producing in commercial quantities.

5        ~~[(14)]~~ "Working interest owner" means the owner of an  
 6 interest in oil or gas burdened with a share of the expenses of  
 7 developing and operating the property.

8        (15) "Workover" means any operation designed to maintain,  
 9 to restore or to increase the production rate, the ultimate recovery  
 10 or reservoir pressure system of a well or group of wells and  
 11 approved by the Division as a workover, a secondary recovery, a  
 12 tertiary recovery, or a pressure maintenance project.

13        Section 2. Section 59-5-102, Utah Code Annotated 1953, as  
 14 last amended by Chapter 4, Laws of Utah 1988, is amended to read:

15        59-5-102. (1) (a) Every person owning an interest, working  
 16 interest, royalty interest, payments out of production, or any  
 17 other interest, in oil or gas produced from a well in the state,  
 18 or in the proceeds of the production, shall pay to the state a  
 19 severance tax ~~[equal to 44 of]~~ based on value, at the well,  
 20 of the oil or gas produced, saved, and sold or transported from  
 21 the field where the substance was produced.

22        (b) The severance tax rate for oil and gas is as follows:

23        (i) 2% of the value up to and including the first \$12.00 per  
 24 barrel for oil, and \$.75 per mcf for gas;

1       (ii) 3% of the value from \$12.01 through \$14.00 per barrel  
2       for oil, and \$.76 through \$1.50 per mcf for gas;

3       (iii) 4% of the value from \$14.01 through \$16.00 per barrel  
4       for oil, and \$1.51 through \$2.00 per mcf for gas; and

5       (iv) 5% of the value from \$16.01 and above per barrel for oil  
6       and \$2.01 per mcf for gas.

7       ~~[(b)]~~ (c) If the oil or gas is shipped outside the state,  
8       this constitutes a sale, and the oil or gas is subject to the  
9       severance tax. If the oil or gas is stockpiled, the tax is not  
10      applicable until it is sold, transported, or delivered. Oil or  
11      gas stockpiled for more than two years however, is subject to  
12      the severance tax.

13      (2) No tax is imposed upon:

14      (a) the first \$50,000 annually is gross value of each well  
15      or wells as defined in this part, to be prorated among the owners  
16      in proportion to their respective interests in the production or  
17      in the proceeds of the production;

18      (b) stripper wells, unless the exemption prevents the  
19      severance tax from being treated as a deduction for federal tax  
20      purposes; ~~[(ex)]~~

21      (c) the first six months of production for wells started  
22      after January 1, 1984 ~~[-]~~ but before January 1, 1990;

23      ~~(d) the first twelve months of production for wildcat wells~~  
24      ~~spudded after January 1, 1990; or~~

25      ~~(e) the first six months of production for development~~  
26      ~~wells spudded after January 1, 1990.~~



1        (3) A working interest owner who pays for all or part of  
2 the expenses of a recompletion or workover is entitled to a tax  
3 credit equal to 20% of the amount paid. The tax credit shall  
4 apply against any severance tax liability of the working interest  
5 owner under this chapter for the taxable year in which the  
6 recompletion or workover is completed.

7        ~~[(3)]~~ (4) These taxes are in addition to all other taxes  
8 provided by law and are delinquent, unless otherwise deferred, on  
9 June 1 next succeeding the calendar year when the oil or gas is  
10 produced, saved, and sold or transported from the premises.

11        ~~[(4)]~~ (5) With respect to the tax imposed by this chapter  
12 on each owner of oil or gas or in the proceeds of the production  
13 of those substances produced in the state, each owner is liable  
14 for the tax in proportion to the owner's interest in the  
15 production or in the proceeds of the production.

16        ~~[(5)]~~ (6) The tax shall be paid by each producer pursuant  
17 to agreement on behalf of the producer and on behalf of each  
18 owner entitled to participate in the oil or gas sold by the  
19 producer or transported by the producer from the field where the  
20 oil or gas is produced.

21        ~~[(6)]~~ (7) Each producer shall deduct the tax from the  
22 amounts due to other owners for the production or the proceeds of  
23 the production.

24        Section 3. This Act has retrospective operation to January  
25 1, 1990.